Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Thompson | Analyst: Jeani Brent | Bill Number: AB 2455

Related Bills: See Legislative History | Telephone: 845-3410 | Introduced Date: 02/24/2000

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Unharvested Fruit Crop Losses Credit/Loss From Fallbrook Mexican Fruit Fly Quarantine

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to the market price of any unharvested fruit grown by a commercial grower that was lost as a direct result of the Fallbrook Mexican Fruit Fly Quarantine.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. The bill specifies that its provisions would apply to the first taxable or income year of the taxpayer that commences on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 2435 (2000) would allow taxpayers a 100% credit equal to the grape crop losses sustained by a grapevine grower because of the Glassy-Winged Sharpshooter pest or Pierce’s Disease.

AB 2170 (2000) would allow a credit equal to an unspecified amount of farm losses suffered by farmers in this state as a result of any natural disaster, including pest infestations.

SB 2104 (2000) would provide an election to expense the cost of certain qualified property and a 100% net operating loss carryover for farmers that experience a “natural or quarantine event.”

AB 122 (Stats. 1997, Ch. 607) allows accelerated depreciation for grapevines infested with Pierce’s Disease.

SB 1778 (Stats. 1992, Ch. 960) allows accelerated depreciation for grapevines infested with phylloxera.

PROGRAM HISTORY/BACKGROUND

The California Department of Food and Agriculture (CDFA) has implemented programs aimed at preventing infestation of a number of agricultural pests, including the Melon fruit fly, the Mediterranean fruit fly, the Oriental fruit fly, and the Mexican fruit fly. The Mexican fruit fly is native to northeastern Mexico and occurs in virtually all fruit growing areas of Mexico. The Mexican fruit fly lays its eggs inside fruit.

Board Position:			Department Director	Date
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Infested fruit spoils, thereby destroying the fruit crop. Fruit crops susceptible to Mexican fruit fly attack include most citrus, apples, apricots, avocados, guavas, peaches, pears, plums, quinces, mangoes, sapotes, cherimoyas, etc.

CDFA has established quarantine for the Mexican fruit fly in the Fallbrook area in San Diego and Riverside Counties and in the Bloomington area of Riverside and San Bernardino Counties. According to CDFA, since 1954, the Mexican fruit fly has been carried into Mexican border areas each year in varying numbers; however, official action thus far has successfully prevented the establishment of the Mexican fruit fly in areas adjacent to California boundaries.

SPECIFIC FINDINGS

Current state and federal law, among other deductions, generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

Under existing state and federal law, any loss sustained during the year that is not compensated for by insurance or otherwise is allowed as a deduction. The amount of loss deduction is limited to the taxpayer's basis in the property that was lost.

Existing state and federal law allows taxpayers to carry forward a net operating loss (NOL). An NOL is defined as the excess of allowable deductions over gross income computed under the law in effect for the loss year. Taxpayers may deduct the carryover amount in subsequent years.

Depending on the type of taxpayer or amount of a taxpayer's income, the amount of the NOL that is eligible to be carried forward and the number of years it can be carried forward will vary. For most taxpayers, 50% of the computed NOL may be carried forward for five years. Special NOL treatment, as stated in the chart below, is provided for the specified taxpayers.

Type of NOL	Carryover %	Carryover Period
General NOL	50%	5 Years
New Business Year 1	100%	8 Years
Year 2	100%	7 Years
Year 3	100%	6 Years
Eligible Small Business	100%	5 Years
Economic Development Areas	100%	15 Years

Under existing state and federal law, farm losses may be either deducted as an ordinary loss, limited to the taxpayer's adjusted basis, in the taxable or income year sustained or included in the determination of the NOL, 50% of which could be carried forward for deduction for up to five years.

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits or the federal reforestation credit).

Neither state nor federal laws currently allow a credit for lost crops.

This bill would allow a credit equal to the market price of any unharvested fruit grown by a commercial grower that was lost as a direct result of the Fallbrook Mexican Fruit Fly Quarantine, as declared on October 30, 1999. "Market price" would be defined as the market price that would have been paid for the unharvested fruit at the estimated harvest time for that fruit.

The Agricultural Commissioner, in consultation with the University of California Cooperative Extension Service, would determine the estimated harvest time and the crop yield for each grower that claims this credit. This bill would allow the tax credit only for farmers who lost crops as a result of the Mexican Fruit Fly quarantine in the Fallbrook area, not for farmers in the Bloomington Quarantine Area.

This bill would allow the credit to be claimed only for the taxpayer's first taxable or income year that begins on or after January 1, 2000.

Policy Considerations

This bill provides taxpayers a 100% credit, which is unprecedented as a matter of state tax policy. Moreover, the taxpayer would be allowed to deduct the expenses related to planting and growing the unharvested fruit. If the taxpayer does not have sufficient income to cover the expense deductions, the taxpayer would realize a net operating loss and be allowed to carry over 50% of the NOL to reduce income in future years.

This bill would allow taxpayers to claim the credit even if the taxpayer received insurance or other compensation for the losses. The department understands from the author's staff that this result is unintended. The attached amendments would ensure that taxpayers could receive the credit only for amounts not compensated for by insurance or otherwise.

This bill would allow the tax credit to farmers in the Fallbrook area, but not to farmers in the Bloomington area, creating an inequity between similar taxpayers who suffered the same loss, based solely on their physical location.

Implementation Considerations

Although this bill specifies that the Agricultural Commissioner would determine the estimated harvest time and crop yield, the bill does not specify how the actual or estimated market price for that crop yield would be determined. Without direction, disputes could arise between the department and the taxpayer with regards to the valuation method used to determine market price. Further, the lack of direction in the bill leaves open the potential for fraud. Pursuant to discussions with the author's staff, the attached amendments would resolve this concern by requiring the Agricultural Commissioner also to determine the market price that would have been paid. In addition, the amendments would require the taxpayer to obtain from the Agricultural Commissioner a certificate showing these determinations. These amendments would resolve the department's implementation concern that it might be unable to verify either the amount of the loss or that the loss was actually sustained. A taxpayer would still be permitted to substantiate these facts independently.

This bill would allow a credit equal to the unharvested fruit grown by a commercial fruit grower that was lost during the taxable or income year. However, this bill does not limit the eligibility of the credit to the taxpayer that incurred losses. As a result, disputes could arise between the department and taxpayers over eligibility for the credit. The department understands from the author's staff that the intent is to limit eligibility for the credit to only those taxpayers who sustain the unharvested fruit losses. The attached amendments would accomplish this intent.

This bill would provide an unlimited carryover of excess credit amounts. Credits with unlimited carryovers must be maintained on tax forms and systems even when the credit has expired. Since tax credits usually are used within eight years, most recently enacted credits contain limited carryover provisions, generally eight or ten years.

FISCAL IMPACT

Departmental Costs

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

Tax Revenue Estimate

The revenue impact of this measure, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of AB 2455 Enactment Assumed After June 30, 2000 (In Millions)			
	2000-1	2001-2	2002-3
Revenue Impact	$-1	$-.75	$-.40

Revenue Estimate Discussion

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

According to a survey of about 200 growers conducted by the California Department of Food and Agriculture, the most recent (February 2000) estimate of total crop loss in California as a result of the Fallbrook Mexican Fruit Fly Quarantine is $2.67 million. According to the experts contacted, this loss constituted, on average, about 20% of the farmers' sales. Not all farmers would be able to take full advantage of the credits when generated because of negative or small net incomes. It is projected that one-half of total generated credits could be applied against available tax liabilities. The unused credits would be carried forward and applied against future tax liabilities until exhausted.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2455
As Introduced February 24, 2000

AMENDMENT 1

@@@@@ **Leg. Counsel:** Please modify Sections 2 and 3 of AB 2455 as follows:

SEC. 2. Section 17053.90 is added to the Revenue and Taxation Code, to read:

17053.90. (a) There shall be allowed as a credit against the "net tax," as defined by Section 17039, to a qualified taxpayer an amount equal to the market price of any unharvested fruit grown by ~~a commercial fruit grower~~ the qualified taxpayer that was lost as a direct result of the Fallbrook Mexican Fruit Fly Quarantine and that was not compensated for by insurance or otherwise. The credit shall be allowed for the first taxable year of the taxpayer that commences on or after January 1, 2000.

(b) For purposes of this section:

(1) "Qualified taxpayer" means a commercial fruit grower.

(2) "Market price" means the market price that would have been paid for the unharvested fruit at the estimated harvest time for that fruit.

~~(2)~~

(c) The Agricultural Commissioner, in consultation with the University of California Cooperative Extension Service, shall ~~determine~~ do all of the following:

(1) Certify the estimated harvest time and crop yield for each ~~commercial fruit grower~~ qualified taxpayer that claims a credit under this section.

(2) Certify the market price that would have been paid to the qualified taxpayer for the unharvested fruit for which the qualified taxpayer claims a credit pursuant to this section.

(3) Certify that the unharvested fruit for which the qualified taxpayer claims a credit pursuant to this section was lost as a direct result of the Fallbrook Mexican Fruit Fly Quarantine.

(4) Certify when the unharvested fruit was lost.

(5) Certify that the taxpayer that claims the credit is a qualified taxpayer pursuant to paragraph (1) of subdivision (b).

(6) Provide the qualified taxpayer a written certification showing each of the items certified in paragraphs (1) through (5), inclusive.

(d) The taxpayer shall do both of the following:

(1) Obtain from the Agricultural Commissioner a written certification pursuant to subdivision (c).

(2) Retain a copy of the certification and make it available to the Franchise Tax Board upon request.

~~(c)~~

(e) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years if necessary, until the credit has been exhausted.

SEC. 3. Section 23690 is added to the Revenue and Taxation Code, to read:

23690. (a) There shall be allowed as a credit against the "tax," as defined by Section 23036, to a qualified taxpayer an amount equal to the market price of any unharvested fruit grown by ~~a commercial fruit grower~~ the qualified taxpayer that was lost as a direct result of the Fallbrook Mexican Fruit Fly Quarantine and that was not compensated for by insurance or otherwise. The credit shall be allowed for the first income year of the taxpayer that commences on or after January 1, 2000.

(b) For purposes of this section:

(1) "Qualified taxpayer" means a commercial fruit grower.

(2) "Market price" means the market price that would have been paid for the unharvested fruit at the estimated harvest time for that fruit.

~~(2)~~

(c) The Agricultural Commissioner, in consultation with the University of California Cooperative Extension Service, shall ~~determine~~ do all of the following:

(1) Certify the estimated harvest time and crop yield for each ~~commercial fruit grower~~ qualified taxpayer that claims a credit under this section.

(2) Certify the market price that would have been paid to the qualified taxpayer for the unharvested fruit for which the qualified taxpayer claims a credit pursuant to this section.

(3) Certify that the unharvested fruit for which the qualified taxpayer claims a credit pursuant to this section was lost as a direct result of the Fallbrook Mexican Fruit Fly Quarantine.

(4) Certify when the unharvested fruit was lost.

(5) Certify that the taxpayer that claims the credit is a qualified taxpayer pursuant to paragraph (1) of subdivision (b).

(6) Provide the qualified taxpayer a written certification showing each of the items certified in paragraphs (1) through (5), inclusive.

(d) The taxpayer shall do both of the following:

(1) Obtain from the Agricultural Commissioner a written certification pursuant to subdivision (c).

(2) Retain a copy of the certification and make it available to the Franchise Tax Board upon request.

~~(c)~~

(e) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years if necessary, until the credit has been exhausted.